IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 362

THE HIRSCH IMPROVEMENT COMPANY,

Petitioner,

—*v.*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

ELLIOT A. DAITZ,
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Law Brief Press—NYC

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To the Honorable Justices of the Supreme Court of the United States:

Your petitioner, the Hirsch Improvement Company, respectfully represents and petitions as follows:

Summary Statement of the Matters Involved.

The petitioner seeks review of the decision of the United States Circuit Court of Appeals for the Second Circuit (L. Hand, Chase and Frank, *JJ.*), affirming on June 5, 1944, (R 262) a decision of the Tax Court of the United States entered on November 21, 1942, finding that there are deficiencies in

income and excess-profits taxes for the calendar year 1936 in the respective amounts of $8,230.33 and $5,939.95.

The case involves two issues, namely:

1. Pursuant to the terms of a twenty-year sublease of a store building, the petitioner, as lessor, in the taxable year 1936 received from its sublessee the sum of $35,000.00 as security for the payment of rent and the performance of the covenants and conditions of the lease. In the event of default by the lessee or termination of the lease prior to its expiration date, the said security was to be retained by the petitioner in payment of its damages. If the petitioner's damages were less than the security the surplus was to be returned to the lessee. Otherwise the petitioner was to apply said sum on account of rent and other payments to be made by the lessee for the last year of the term of the lease.

The Commissioner of Internal Revenue included the $35,000.00 in the petitioner's taxable gross income for year 1936 and was sustained in his action by the Tax Court and the Circuit Court of Appeals.

The petitioner contends that the $35,000.00 was a security deposit which should not have been included in its income for year 1936.

2. The petitioner owned a sublease on a building in Cleveland, Ohio, which it had leased out in its entirety to two tenants. Upon the facts hereinafter set forth the Commissioner of Internal Revenue determined that the petitioner was carrying on or doing business within the meaning of Section 105 of the Revenue Act of 1935, and that it therefore was subject to declared value excess-profits tax for year 1936. The Commissioner's action was sustained by the Tax Court and the Circuit Court of Appeals.

The petitioner contends that the determination is not in accord with the applicable decisions of this Court.

The Statutes and Regulations.

REVENUE ACT OF 1936:

"*Sec. 21.* 'Net income' means the gross income computed under section 22, less the deductions allowed by section 23."

"*Sec. 22.* 'Gross income' includes gains, profits, and income derived from * * * rents, * * *."

"*Sec. 41.* The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but, if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *"

"*Sec. 42.* PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *"

REGULATIONS 94:

"*Art. 41-1. Computation of net income.*—The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. * * *"

"*Art. 41-2.* * * * All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order to clearly reflect income such amounts are to be properly accounted for as of a different period."

REVENUE ACT OF 1935 (as amended by Revenue Act of 1936)

"*Sec. 105(a)* For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax * * *."

"*Sec. 106.* EXCESS PROFITS TAX

"(a) There is hereby imposed upon the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 105, an excess profits tax equal to the sum of the following:

"6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

"12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

"(b) * * *. For the purposes of this section the net income shall be the same as the net income for income tax purposes for the year in respect of which the tax under this section is imposed, computed without the deduction of the tax imposed by this section. * * *."

EXCESS-PROFITS TAX REGULATIONS (T. D. 4666)

"*Art. 2. Scope of Tax.*—The excess-profits tax, imposed by section 106 of the Revenue Act of 1935, as amended, is imposed upon a certain portion of the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which the corporation is subject to the capital stock tax imposed by section 105 of that act."

REGULATIONS 64 (1936 EDITION)

"*Art. 43.* * * *

"(b) *Exceptions.*—Ordinarily the exceptions to 'doing business' are restricted to limited activities of a corporation, such as—

* * * * *

"(2) the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in the case in which the corporation either was organized for, or has reduced its activities to, the mere owning and holding of specific property."

The Facts.

The petitioner's books are kept and tax returns filed on a cash basis (R. 32).

During year 1936 the petitioner was the owner of a 99-year lease dated April 16, 1915 covering certain property in Cleveland, Ohio, known as the Argyle Block (R. 33). On or about February 27, 1936, the petitioner subleased a portion of the premises to McCrory Stores Corporation, the agreed terms of which were as follows: the lease was to cover the period from June 1, 1936 to December 31, 1955; the lessee agreed to deposit with petitioner the sum of $35,000.00 in cash as security for the rent and performance of the conditions of the lease, such sum to be applied under certain conditions as rent for the year ending December 31, 1955; the rental agreed upon was $30,000.00 per annum for the first seven years of the lease and $32,500.00 per annum thereafter; and the lessee proposed to anticipate the rental to the extent of $2,500.00 per annum for ten years, so that $25,000.00 would be received upon execution of the lease, thereby reducing the rental to be reserved in the lease to $27,500.00 per annum for the first seven years, $30,000.00 per annum for the next three years, and $32,500.00 per annum for the balance of the term. The lease was executed on February 27, 1936, and the rental as stated in the lease was $25,000.00 in cash on the signing and delivery thereof, $27,500.00 per annum for the first seven years of the term, $30,000.00 per annum for the next three years, and $32,500.00 per annum for the balance of the term. In addition the lease provided in a separate paragraph as follows:

> The lessee has, on delivery hereof, paid to the lessor the sum of thirty-five thousand dollars ($35,000), the receipt of which is hereby acknowledged, as security for the payment of rent and the performance of the

covenants and conditions of this lease on the part of the lessee to be performed. It is understood and agreed that the lessor shall apply said sum on account of the rent and other payments herein provided to be made for the year ending December 31, 1955, except that in the event of default in the payment of rent or in the performance of the material and important covenants contained in this lease on the lessee's part to be performed, and the termination of this lease pursuant to the terms hereof prior to January 1, 1955, in which event the said security shall be retained by the lessor in payment of or on account of such damages as the lessor may sustain by reason of the termination of the lease because of the default on the part of the lessee. In the event such damages shall be less than the amount paid as such security the surplus, if any, shall be paid to the lessee, by the lessor (R. 40, 143-146).

The lease also provided that in the event the demised premises shall be destroyed or so seriously damaged by fire or otherwise as to require rebuilding, and if petitioner should be unable or fail to rebuild the premises so as to be ready for occupancy within six months, the sublessee might at its option terminate the lease and upon such termination "all rent paid in advance shall be equally apportioned and the unearned portion refunded to Lessee" (R. 154, 155). It was further provided that if the whole or any part of the premises should be taken by condemnation petitioner would have the right to terminate the lease, in which event "any rent paid in advance shall be prorated and rebated," but that if only a part of the premises were so taken and petitioner did not elect to terminate "proper adjustment in the rent shall be made based upon the amount of square footage taken in said condemnation as against the amount of square footage hereby demised, and Lessor shall refund to Lessee

the proper proportion of any rent of that part of the premises so taken as has been paid in advance, * * *" (R. 157, 158).

McCrory Stores Corporation agreed to pay to petitioner one-half of all taxes and assessments levied upon the premises of which the demised premises formed a part, together with one-fourth of all premiums for fire and/or lightning insurance (R. 148, 149).

In accordance with the provisions of the lease, the petitioner on March 2, 1936, received from McCrory Stores Corporation the sums of $25,000.00 and $35,000.00 (R. 40). It did not report the $35,000.00 as gross income for the tax year, and reported only a portion of the $25,000.00 item. The Commissioner included both the amounts of $25,000.00 and $35,000.00 within petitioner's gross income. The petitioner has conceded that the $25,000.00 item was taxable income in its entirety in the tax year, but contends that the $35,000.00 security deposit should not be included in income for year 1936 (R. 41).

The petitioner was incorporated on March 16, 1922, for the purpose, as stated in its articles of incorporation, "of acquiring, owning, leasing, improving and developing real estate; constructing and maintaining buildings thereon; leasing and operating the same; mortgaging or otherwise incumbering the same and doing all things necessary and incidental thereto" (R. 32, 33).

The actual purpose for which the petitioner was organized was to acquire from Paul Hirsch, one of its stockholders, the 99-year leasehold on the Argyle Block which he owned (R. 233). This lease was assigned to the petitioner two days after its incorporation (R. 33). On March 21, 1922, the petitioner executed a new sublease of the entire premises to The Hirsch Company, the then occupant of the premises, for a term of twenty years, commencing March 1, 1922, at a rental of $50,000.00 per year (R. 33).

On March 24, 1924, the petitioner executed a sublease of the same premises to McCrory Stores Corporation, for a period of ninety years commencing April 1, 1924, at an annual rental of $67,500.00 (R. 34).

From 1924 to 1933, McCrory Stores Corporation was the sole tenant of the taxpayer's leasehold. Since 1933, that company has occupied only a portion of the premises, by reason of the fact that it went into a bankruptcy reorganization proceeding, and the remainder has been sublet to Robin Redbreast Hosiery Co., Inc. under a lease for a period ending June 30, 1945 (R. 233).

Since its incorporation, the petitioner's income has been derived from its leasehold and it has never acquired any other property (R. 233). Its cash receipts during the period July 1, 1935 to June 30, 1936 consisted of rent and three payments made by McCrory Stores Corporation, making a total of $205,000.00 (R. 164, 165). The three payments by McCrory Stores Corporation consisted of the $35,000.00 security deposit and $25,000.00 advance rental hereinabove mentioned, plus the sum of $90,000.00 received in settlement of a claim which the petitioner had filed against McCrory Stores Corporation in bankruptcy (R. 165).

The petitioner's cash disbursements during the period from July 1, 1935 to June 30, 1936 aggregated $183,000.00, consisting chiefly of approximately $30,000.00 as ground rent, $15,000.00 as taxes and insurance, $105,000.00 as dividends and advances to shareholders, $4,000.00 as commissions, $1,200.00 for traveling expenses, bookkeeping and sundry other expenses, the greater part of which were incurred in connection with the settlement with McCrory Stores Corporation, and $18,000.00 as legal expenses connected with the said settlement and the execution of leases. Petitioner paid no salaries to its officers or directors during the said period (R. 166-168, 235).

In the tax year, effective September 1, 1936, the petitioner employed a bank in Cleveland as its agent in the collection of rentals and the payment of the ground rent and taxes due from petitioner (R. 233, 242-246). Any balance of income remaining was to be disbursed by the agent on the petitioner's written instructions (R. 242-246).

During the period July 1, 1935 to June 30, 1936, petitioner did not supply heat, light, water, or janitor service to its two tenants. It made no repairs to the premises. It did not buy, sell or exchange any assets (R. 234). During this period time and effort were required in securing the settlement with McCrory Stores Corporation (R. 235). The lease to Robin Redbreast Hosiery Company, Inc. was executed on July 1, 1935 (R. 235). The board of directors held three special meetings between July 1, 1935 and June 30, 1936, and these were the only formal directors' meetings that were held (R. 45). No formal meeting of the stockholders was held during that period (R. 45). The Robin Redbreast Hosiery Company, Inc. covenanted in its lease to keep and maintain the premises demised to it, including plumbing and electrical fixtures, elevators, etc. in good condition and repair (R. 126). Petitioner covenanted to make all necessary repairs to the roof and sidewalk adjoining the premises (R. 127). McCrory Stores Corporation covenanted in its lease to keep the interior of the premises demised to it in good repair, including the store fronts, show windows and the entrance way; and petitioner covenanted to keep the exterior of the premises, including sidewalk, in good repair, and to carry insurance against fire and/or lightning (R. 147, 151). Similar covenants regarding repairs were contained in the prior lease to McCrory Stores Corporation and in the original lease to The Hirsch Company (R. 46-52, 69-95).

Petitioner reported an excess profits tax liability of $5,369.23 for the year 1936 which it paid together with its

income tax in three installments on June 15, September 24 and December 11, 1937 (R. 41). On March 15, 1940, it filed claim for refund of the excess profits tax so paid upon the ground that it was not engaged in carrying on business during the period July 1, 1935 to June 30, 1936, and therefore was not liable for capital stock tax or excess profits tax (R. 42).

On or after August 13, 1940, the Commissioner mailed to the petitioner a notice of deficiencies in Federal Income and Excess-Profits taxes for the calendar year 1936 in the respective amounts of $17,014.24 and $7,310.72. In arriving at the said deficiencies the Commissioner among other things, determined that the $35,000.00 received by the petitioner as security in year 1936 under its lease to the McCrory Stores Corporation was income to the petitioner and that the petitioner was carrying on business during the period from July 1, 1935 to June 30, 1936 and was therefore subject to declared value excess-profits tax (R. 22-27).

On November 11, 1940, the petitioner filed a petition with the United States Board of Tax Appeals appealing from the deficiency set forth in the notice of deficiency aforesaid. On November 10, 1941, the petitioner filed an amended petition, alleging among other things that the Commissioner, in adjusting the petitioner's net income reported for the calendar year 1936, had erroneously added said $35,000.00 security deposit to the petitioner's reported net income and that the Commissioner had erroneously determined that the petitioner was engaged in carrying on business during the period from July 1, 1935 to June 30, 1936 and was subject to the declared value excess-profits tax (R. 4-21).

On October 6, 1942 the United States Board of Tax Appeals entered its memorandum opinion, wherein it upheld the Commissioner's said determinations (R. 180-200).

On November 21, 1942, the Board entered its final order of redetermination, wherein and whereby it ordered and de-

cided that there are deficiencies in income and excess-profits taxes for the calendar year 1936 in the respective amounts of $8,230.33 and $5,939.95 (R. 201).

The petitioner thereupon appealed to the Circuit Court of Appeals for the Second Circuit, which Court affirmed the determination of the Tax Court (R. 202-214).

The Opinions Below.

The Tax Court's Memorandum Findings of Fact and Opinion are set forth in the Record at pages 180 to 200.

The decision of the Circuit Court of Appeals was promulgated on May 19, 1944 (No. 55), and is not yet officially reported. (55-361)

The Circuit Court of Appeals held that the $35,000.00 was income to the petitioner primarily upon a determination that it was to be repaid under circumstances which might never occur. This determination is in conflict with decisions of another circuit on similar facts and does not give due effect to the contractual intention of the parties to the lease that the money was paid and received as a security deposit which could not become rental income, if at all, until some future date.

The Circuit Court of Appeals further held that the petitioner was doing business in 1936, upon the basis of its opinion in *New London Northern R. R. Co.* v. *Thomas S. Smith,* 141 F. (2d) 219. This decision is in conflict with applicable decisions of this honorable Court.

Jurisdiction.

The Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, §1 (43 Stat. 938), 28 U. S. C. A. §347 (a).

Questions Presented.

1. Was the $35,000.00 security deposit received by the petitioner in year 1936 taxable gross income within the meaning of the Internal Revenue Laws and the intent of Congress?

2. Under the facts in this case, was the petitioner during the period from July 1, 1935 to June 30, 1936, carrying on or doing business within the meaning of Section 105 of the Revenue Act of 1935, so as to subject it to declared value excess-profits tax liability under Section 106 of the Revenue Act of 1935, as amended by the Revenue Act of 1936?

3. Is the petitioner entitled to a refund of the excess-profits tax paid by it for year 1936 in the sum of $5,369.23, plus interest thereon?

Reasons Relied on for the Allowance of the Writ.

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. The unsettled state of the interpretation of the taxing statutes as applied to money received as a security deposit under the terms of a lease is clearly illustrated by the following conflicting decisions of the Circuit Court of Appeals:

> *Clinton Hotel Realty Corp.* v. *Commissioner,* 128 F. (2d) 968, decided on June 27, 1942 by the Circuit Court of Appeals for the Fifth Circuit;
> *Warren Service Corporation* v. *Commissioner,* 110 F. (2d) 723, decided on March 25, 1940 by the Circuit Court of Appeals for the Second Circuit;

Astor Holding Co. v. *Commissioner*, 135 F. (2d) 47, decided on April 27, 1943 by the Circuit Court of Appeals for the Fifth Circuit;

Commissioner v. *Lyon*, 97 F. (2d) 70, decided on May 27, 1938 by the Circuit Court of Appeals for the Ninth Circuit.

A definite determination of whether and when a security deposit should be included in gross income is of the utmost importance to innumerable real estate owners and lessors, who are daily confronted with this problem. The conflict of opinion on the question directly affects the provisions of leases now in force. The unsettled state of the interpretation of the law has caused confusion among taxpayers who await clarification of the issue.

The determination of the Circuit Court of Appeals on the "doing business" question is in conflict with the weight of authority and applicable decisions of this Court. This Court has held that the mere receipt of income from property leased and the distribution thereof among the corporation's stockholders does not constitute doing business. The Circuit Court's determination that the petitioner was doing business is erroneously based upon the petitioner's activity in protecting its leasehold investment. The nebulous state of confusion existing in the numerous recent decisions require that this Court settle the question.

If, as we urge, the decision of the Circuit Court of Appeals is erroneous, undue prejudice will result to many taxpayers unless the applicable principles are settled by this Court.

WHEREFORE, petitioner prays that a writ of certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second

Circuit, commanding that Court to certify and send to this Court for review and determination, as provided by law, this cause and a complete transcript of the record and of all proceedings had herein; that the order of the United States Circuit Court of Appeals affirming the decision of the Tax Court of the United States may be reversed; and that petitioner may have such other and further relief in the premises as this Court may deem proper.

Dated, August 16th, 1944.

ELLIOT A. DAITZ,
Counsel for Petitioner.

I HEREBY CERTIFY that I have examined the foregoing petition for a writ of certiorari and that in my opinion it is well founded and the cause is one in which the petition should be granted.

ELLIOT A. DAITZ,
Counsel for Petitioner.

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Petitioner,

—*v.*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

Jurisdiction.

The statement of jurisdiction is set forth in the foregoing petition.

Statement of the Case.

The facts have been set forth in the foregoing petition.

SUMMARY OF ARGUMENT

POINT I.

The Court erred in determining that the $35,000.00 security deposit should be included in income.

POINT II.

The Court erred in determining that the petitioner was doing business in the year ended June 30, 1936.

POINT III.

The Court erred in failing to determine that the petitioner was entitled to a refund of excess-profits tax paid for year 1936 in the amount of $5,369.23, plus interest thereon.

POINT I.

The Court erred in determining that the $35,000.00 security deposit should be included in income.

We have been unable to find a case in this Court which bears directly upon the question of what constitutes a security deposit and when such deposit is to be included in gross income.

The Tax Court found that the $35,000.00 was deposited with the petitioner "*as security for the rent and performance of the conditions of the lease* * * *;" (R. 186). (Italics ours.)

In its opinion, the Tax Court stated:

> "In the case at bar the fund was to serve a *dual purpose* as *security* and as rent. * * * " (R. 196). (Italics ours.)

Under the rule announced by this Court in the case of *Dobson* v. *Commissioner*, 320 U. S. 489, the Tax Court's finding that the $35,000.00 was security must be given controlling weight in arriving at a conclusion as to its taxability. The determination by the lower courts that the fund was taxable in the year of receipt was inconsistent with the finding that it was security, and constituted an erroneous application of the legal principles governing the taxability of the fund as announced by the Circuit Court of Appeals, Fifth Circuit, in the case of *Clinton Hotel Realty Corporation* v. *Commissioner*, 128 F. (2d) 968.

The similarity of the facts in this case to those in the *Clinton Hotel* case, *supra* clearly demonstrate the conflict created by the Circuit Court's decision in the instant case. *Neither the Tax Court nor the Circuit Court has advanced any clear distinction between the instant case and the Clinton decision.* In fact, the Circuit Court recognized the existing conflict, saying:

> "Expressions in Clinton Realty Corp. v. Commissioner, 128 F. (2d) 968 (C. C. A. 5) *so far as they may appear to be inconsistent with our decision,* were qualified by a subsequent case in the same Circuit, Astor Holding Co. v. Commissioner, 135 F. (2d) 47 (C. C. A. 5) * * *." (Italics ours.)

The distinction between the *Astor Holding Co.* case and the instant case is indicated by the following language in the Circuit Court's decision:

> "The payment involved in the Clinton Hotel Case was 'always referred to as a "security" or as a "deposit", and it was obvious that there were many things to which it might become applicable besides the tenth year's rent'. * * *."

A further distinction between the two cases is found in the Tax Court's memorandum opinion, stating:

> "At no place in the lease is the payment in question designated other than by such terms as 'rent' or 'moneys' theretofore paid on account of this lease! Nowhere does the lease designate this sum or any part of it as 'security' for any purpose."

It is strongly urged that the principle of the *Clinton Hotel* case, *supra* is applicable to the facts herein. The

legal rules governing the question at issue were stated by the court as follows:

> "It is not denied that if the $21,000 was paid and received as rent in advance, it was taxable, though not yet earned. *United States* v. *Boston & Providence R. R. Corp.*, 37 F. (2d) 670; *Renwick* v. *United States*, 87 F. (2d) 123; *Commissioner* v. *Lyon*, 97 F. (2d) 70. On the other hand, if it was paid and received as security, with no present right or claim of full ownership, it would not be presently income, although it was expected finally to be applied in payment of the last year's rent if nothing happened to prevent. *Barker Estate*, 13 B. T. A. 562; *Warren Service Co.* v. *Commissioner*, 110 F. (2d) 723. *In the latter situation, though the money is rightfully received, and if the parties so intend may be freely used, yet because of the acknowledged liability to account for it, there is no gain; just as in borrowing there is none.* The case of *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, 424 has no application, for the recipient of the money there claimed it was fully his, he acknowledged no right in another, and the holding was that a contrary claim by that other which might prove good would not prevent the receipt of the money being present income." (Italics ours.)

The rule announced by this Court, that taxable income results from money received under a claim of right and without restriction as to its use, does not apply to the instant case. The facts clearly show that the $35,000.00 security, as contrasted with the $25,000.00 advance payment, was paid and received as security with no present right or claim of *full* ownership.

In the instant case, the lower courts have based their decisions in part upon the erroneous determination that the application of the fund to purposes other than rent was a condition subsequent to its serving as rent. The contrary is strongly urged by your petitioner. The application of the fund as rent was a definite condition subsequent which could only become effective *after* it had served as security. Consistently and logically the fund must be security first, and *subsequently only*, may possibly be applied as rent.

The petitioner was liable to account for the fund to its sublessee until the last year of the rental term. Only then, —after giving its sublessee possession of the demised premises,—could the petitioner have the unrestricted *full* ownership of the security fund. The money was not includible in the petitioner's gross income until its character as rent became definitely ascertainable. (*Virginia Iron, Coal & Coke Co.* v. *Commissioner*, 99 F. (2d) 919 (C. C. A. 4), cert. den. 307 U. S. 630.)

In *Virginia Iron, Coal & Coke Co.* v. *Commissioner*, 99 F. (2d) 919 (C. C. A. 4) cert. den. 307 U. S. 630, the recognized rule applicable to the instant case was stated as follows:

> "That, when it became possible to determine the character of the payments and to definitely ascertain that they were income to the taxpayer as payments for an option, they should be taxed, is not to be disputed."

The continuing right of the lessee of the premises in the $35,000.00 security prevents the Commissioner from burdening the fund with a tax obligation or liability. In the event the lessee should become bankrupt or make an assignment for the benefit of creditors, the petitioner could not retain the security. (*Cain* v. *Brown, Assignee*, 105 Ohio St. 264,

136 N. E. 916; *Floro Realty & Investment Co.* v. *Steem Electric Corporation, et al.,* 128 F. [2d] 338; *Remington on Bankruptcy,* Vol. 3, Sec. 1211.01; 8 *C. J. S.,* 173; *Jensen* v. *Sparks,* 53 F. [2d] 433.)

Actually, the $35,000.00 was a pledge which created the relationship of debtor and creditor, and the recognized rule that no income results from borrowing was erroneously disregarded.

In Vol. 36 Corpus Juris, page 296, Landlord & Tenant, section 1063, it is said:

> "Money deposited by a tenant with the landlord as security for the payment of rent or the performance of other covenants constitutes a *pledge,* * * *."

See also:

> *Mendelson-Silverman, Inc.* v. *Malco Trading Corp.,* 146 Misc. 215 (affd. 262 N. Y. 621);
> *Shattuck* v. *Buek,* 158 App. Div. 709 (N. Y.);
> *Matter of Atlas,* 217 App. Div. 38 (N. Y.);
> *Cain* v. *Brown,* 136 N. E. 916, 105 Ohio St. 264.

In *Matter of Atlas,* 217 App. Div. 38 (N. Y.), a tenant had deposited the sum of $5,000.00 with the landlord to be held by the landlord "as security for the performance of this lease and every condition thereof and shall apply to the last month's rent of the term herein, on conditions hereinafter set forth. * * *."

In construing the nature of this deposit, the Court said (p. 41):

> "The first question that arises relates to the character of the $5,000.00 payment. Did it become the property of the lessors upon payment, or did it continue the

> property of the lessee? * * * but one conclusion in our opinion can fairly be drawn from the evidence, namely, that the sum was paid to the lessors *as a fund continuing to belong to the lessee,* but entrusted to the lessors to hold as security against defaults of the lessee in accordance with the terms of the lease, and finally, if not previously required to make good defaults of the lessee, to be applied in payment of the rent for the last months of the term. * * *."

In the light of the State Court decisions that similar deposits represent security and create a debtor-creditor relationship, the lower courts should have determined that no taxable income resulted to your petitioner from the receipt of the $35,000.00 by the petitioner in year 1936.

The impropriety of the Tax Court's determination in respect of said security is further demonstrated by reference to the provisions of sections 41 and 42 of the Revenue Act of 1936 and Regulations thereunder. These statutes and regulations are hereinabove set forth (see p. 3), and provide, in effect, that each year's income must be accounted for in a manner which clearly reflects the taxpayer's annual income.

The inclusion of the $35,000.00 security in petitioner's taxable income for year 1936 would not clearly reflect the petitioner's actual net income for either year 1936 nor year 1955, the last year of the term of the McCrory sublease.

The petitioner is required in each year to pay to the owner of the property annual rent of $27,500.00 under its own lease of the premises. The petitioner also pays other deductible expenses in each year. (See Petitioner's 1936 Income Tax Return, R. 216, also Exhibit "N" attached to Stipulation of Facts, R. 166-168.)

Out of each year's annual rental income received by the petitioner, it must pay, and should be permitted to deduct

its own rent and expenses in order to clearly reflect its true annual net taxable income.

If the $35,000.00 security, which it is submitted was not income at all to the petitioner, were required to be included in its 1936 taxable income, the petitioner's income would be highly exaggerated and not in accordance with the actual facts. The deductions which will become applicable to the property in year 1955, and which properly should be offset against rental income for year 1955, are not allowable to the petitioner in year 1936. A converse situation would occur in year 1955.

It is respectfully urged that Congress never intended to create such a situation in respect of *any* taxpayer. The Commissioner's regulations clearly show that the determination against this taxpayer is contrary to the Commissioner's own interpretation under the Acts of Congress.

In *Knowlton* v. *Moore,* 178 U. S. 41, 77, this Court said:

> "* * * where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute."

The inequality and injustice which would result in this case should be avoided.

In *Gould* v. *Gould,* 245 U. S. 151, 153, this Court said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. *In case of doubt they are construed most strongly against the government, and in favor of the citizen. United States* v. *Wig-*

glesworth, 2 Story, 369; *American Net & Twine Co.* v. *Worthington,* 141 U. S. 468, 474; *Benziger* v. *United States,* 192 U. S. 38, 55." (Italics ours.)

In the instant case the lower courts have extended the Congressional definition of "gross income" to include that which was not income and might never become income to the petitioner.

POINT II.

The Court erred in determining that the petitioner was doing business in the year ended June 30, 1936.

This Court has recently recognized the existing conflict and confusion in the cases involving the question of what constitutes carrying on or doing business. Speaking for the Court in *Magruder* v. *Washington, Baltimore and Annapolis Realty Corp.* (307 U. S. 69), Mr. Justice Murphy said:

> " * * * The crucial words of the statute, 'carrying on or doing business', are not so easy of application to varying facts that they leave no room for administrative interpretation or elucidation. To be sure, in many * * * instances, the factual situation will be so extreme as to leave no doubt whether a corporation is doing business or not. *But the nuances of facts between the two extremes have produced a nebulous field of confusion* * * *." (Italics supplied.)

The petitioner's activities in year 1936 consisted of subleasing its premises, distributing the avails of its property, and making disbursements to cover expenses incurred in connection with litigation with one of its lessees. It paid no salaries either to its officers or its directors.

Mr. Justice Holmes, speaking for this Court in *United States* v. *Emery, Bird, Thayer Realty Company* (237 U. S. 28), concluded:

> "The claimants' characteristic charter function, and the only one that it was carrying on, was the bare *receipt and distribution to its stockholders of rent from a specified parcel of land.* Unless its bare existence as an intermediary was doing business, it is hard to imagine how it could be less engaged." (Italics ours.)

The decision of the Circuit Court of Appeals for the Second Circuit in the instant case not only is in conflict with the foregoing decision of this Court, but also is not in accord with the following cases decided by this Court and with decisions of various Circuit Courts in favor of taxpayers wherein this Court has denied certiorari or no certiorari proceedings have been instituted:

McCoach v. *Minehill & Schuylkill Haven R. Co.*, 228 U. S. 295;

Rose v. *Nunnally Inv. Co.*, 22 F. (2d) 102 (C. C. A. 5). Certiorari denied, 276 U. S. 628;

Goodyear Investment Corporation v. *Campbell*, 139 F. (2d) 188 (C. C. A. 6). (No certiorari proceedings instituted);

Argonaut Consolidated Mining Co. v. *Anderson*, 52 F. (2d) 55 (C. C. A. 2). Certiorari denied, 284 U. S. 682;

Sears, et al. v. *Hassett*, 111 F. (2d) 961 (C. C. A. 1). (No certiorari proceeding instituted);

North Pa. R. Co. v. *Rothensies*, 134 F. (2d) 333 (C. C. A. 3). (No certiorari proceedings instituted);

Continental Baking Corp. v. *Higgins,* 130 F. (2d) 164 (C. C. A. 2). (No certiorari proceedings instituted);

General Ribbon Mills, Inc. v. *Higgins,* 115 F. (2d) 472 (C. C. A. 2). (No certiorari proceedings instituted).

It is respectfully submitted that the facts herein clearly show that the petitioner was not carrying on business during the period from July 1, 1935 to June 30, 1936, and was not subject to excess-profits tax. Liability for such tax is conditioned upon liability for the capital stock tax,[1] which in turn requires for its imposition the carrying on or doing of business.[2]

During the year ended June 30, 1936, the petitioner was merely a lessor whose activities were restricted exclusively to the holding and *preservation* of its leasehold, and the receipt and distribution of its rental income. Its sole investment was its Cleveland leasehold.

The petitioner at no time sought new ventures or profits. It did not exchange any of its assets nor did it buy or sell anything (R. 234). Whatever activities it had were confined solely to the preservation of its leasehold investment.

The applicable opinions of this Court have been expounded somewhat exhaustively, yet tersely, by the Circuit Court of Appeals for the Sixth Circuit in the case of *Goodyear Investment Corporation* v. *Campbell,* 139 F. (2d) 188, decided on December 2, 1943. (No certiorari proceedings were instituted by the solicitor-general). There the Court said:

---

1. See section 106 of the Revenue Act of 1935 as amended by section 402 of the Revenue Act of 1936.

2. See section 105 of the Revenue Act of 1935 as amended by section 401 of the Revenue Act of 1936.

"It is doubtful that the Congress intended to exempt from the capital stock tax a pure holding company engaged in no activity but the ownership of securities and collecting and distributing dividends thereon, and to tax a pure holding company of improved real estate engaged in no activities but the collection of rents *and the safeguarding of its interests under the terms of the lease. There is no reasonable basis for such distinction and the controlling cases would seem to indicate that there is none. The corporation in McCoach* v. *Minehill Ry. Co., supra, held title to leased railroad property from which it collected rents,*—it was not carrying on *business.* In *U. S.* v. *Emery, Bird, Thayer Co., supra,* a corporation was organized to hold title to property and lease it to its parent company, receiving rents from the parent and distributing them to the stockholders, the lease providing that the lessor was to rebuild if the property should be destroyed,—the corporation was not doing business. * * *."

The petitioner had originally subleased its leasehold to but one tenant. The property was so occupied from 1924 until 1933, when the sole tenant went into bankruptcy (R. 233). The petitioner then stepped in to *protect its holdings* and negotiated for a short term lease (R. 233). In 1933, the petitioner was compelled to sublease a part of its leasehold to protect its investment (R. 233).

The petitioner did not operate the property and had no operating expenses. The execution of two leases (one on July 1, 1935 and the other in February, 1936), were but a continuation of the two existing tenancies, and were necessary for the preservation of petitioner's own leasehold, not for the purpose of seeking new or additional profits. Under these two subleases, the sublessees were required to operate the property.

The petitioner's prosecution of a claim against McCrory Stores Corporation, in bankruptcy, upon its previous default was not an activity for profit, but was merely an attempt to recover moneys owing to the petitioner. Its expenditures for legal services were chiefly in connection with the prosecution of said claim.

Can it be said that necessary activities thrust upon the petitioner in preservation of its investment constitute carrying on or doing business? In the light of this Court's decisions on the subject, we think not—no more so than the collection and reinvestment of proceeds of maturing securities, or the prosecution by a bondholder of a claim arising out of default by a corporation on its obligation. Clearly the bondholder who seeks to recover and protect his investment is not doing business. Nor did this petitioner do business when it acted to protect its leasehold investment.

In *McCoach* v. *Minehill & Schuylkill Haven Railroad*, 228 U. S. 295, this Court held that a railway corporation after it had leased its railroad to another company, which operated it, was not doing business, saying:

> "In our opinion, the mere receipt of income from the property leased (the property being used in business by the lessee, and not by the lessor) and the receipt of interest and dividends from invested funds, bank balances, and the like and the distribution thereof among the stockholders of the Minehill Company amount to no more than receiving the ordinary fruits that arise from the ownership of property."

It is strongly urged that this Court's foregoing decision is controlling in the instant case and that the decision of the Circuit Court of Appeals is inconsistent with principles announced by this Court.

POINT III.

The Court erred in failing to determine that the petitioner was entitled to a refund of excess-profits tax paid for year 1936 in the amount of $5,369.23, plus interest thereon.

If the petitioner is sustained upon the second issue herein, it follows that its claim for refund of excess-profits tax for year 1936 in the sum of $5,369.23, plus interest, should be allowed in full.

CONCLUSION.

It is respectfully prayed that this petition for certiorari be granted.

Respectfully submitted,

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Counsel for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 362

THE HIRSCH IMPROVEMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the United States Board of Tax Appeals (now the Tax Court of the United States) (R. 180–200), entered October 6, 1942, are unreported. The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. 255–261) is not yet reported.

JURISDICTION

The judgment of the circuit court of appeals was entered June 5, 1944. (R. 262.) The petition for a writ of certiorari was filed August 18,

1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Pursuant to the terms of a twenty-year sublease of a store building in Cleveland, Ohio, entered into by the petitioner with McCrory Stores Corporation, the lessee paid the petitioner $35,000, in the tax year 1936, to be applied by petitioner on account of rent and other payments to be made by the lessee for the last year of the term, unless it was otherwise applied upon a sooner termination of the lease as therein provided.

The question is whether the court below erred in affirming the decision of the Tax Court sustaining the Commissioner's inclusion of this amount in the petitioner's gross income for that year under Section 22 (a) of the Revenue Act of 1936.

2. Whether the petitioner was doing business in the tax year 1936 so as to subject it to the excess profits tax imposed by Section 106 (a) of the Revenue Act of 1935.

STATUTES INVOLVED

Revenue Act of 1935, c. 829, 49 Stat. 1014:

> SEC. 105 [as amended by Sec. 401 (a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648]. CAPITAL STOCK TAX.[1]

[1] The 1936 amendment merely reduced the capital stock tax from $1.40 for each thousand of the adjusted declared value of the corporation's capital stock to $1 per thousand.

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

SEC. 106. EXCESS-PROFITS TAX.

(a) There is hereby imposed upon the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 105, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

* * * * *

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from pro-

> fessions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

STATEMENT

The petitioner was organized in 1922 for the purpose of taking over a 99-year lease on the Argyle Block in Cleveland, Ohio (R. 182–183). On March 24, 1924, the petitioner subleased the premises to McCrory Stores Corporation for a period of 90 years at an annual rental of $67,500 (R. 183).

On January 14, 1933, McCrory Stores Corporation filed a petition in bankruptcy, its sublease of the premises being thereafter disaffirmed by the trustee (R. 184). Later the petitioner settled its claim in bankruptcy against the McCrory Stores Corporation and entered into a new sublease with it for the period from June 1, 1936, to December 31, 1955. The rental agreed upon was $30,000 per annum for the first seven years of the lease and $32,500 per annum thereafter. The lessee agreed to anticipate the rental to the extent of $2,500 per annum for the first ten years by the payment of an additional sum of $25,000 upon the execution of the lease. (R. 185–186.) The lease

then provided for the payment of the $35,000, here in question, as follows (R. 186–187; see also the lease, R. 146):

> The lessee has, on delivery hereof, paid to the lessor the sum of thirty-five thousand dollars ($35,000), the receipt of which is hereby acknowledged, as security for the payment of rent and the performance of the covenants and conditions of this lease on the part of the lessee to be performed. It is understood and agreed that the lessor shall apply said sum on account of the rent and other payments herein provided to be made for the year ending December 31, 1955, except that in the event of default in the payment of rent or in the performance of the material and important covenants contained in this lease on the lessee's part to be performed, and the termination of this lease pursuant to the terms hereof prior to January 1, 1955, in which event the said security shall be retained by the lessor in payment of or on account of such damages as the lessor may sustain by reason of the termination of the lease because of the default on the part of the lessee. In the event such damages shall be less than the amount paid as such security the surplus, if any, shall be paid to the lessee. by the lessor.

The petitioner determined that neither the $25,000 above referred to nor the $35,000 here involved represented income, and that, therefore, these sums could not be distributed as dividends.

Nevertheless, the petitioner distributed $55,000 (of the total of $60,000) to its stockholders as "advances," and the amounts thus distributed were carried on the balance sheet as assets. The so-called advances were made without any intention or agreement that they should be repaid. No notes were given; the principal was not repaid, and no interest thereon has ever been paid. (R. 188–189.) Before the Tax Court, the petitioner claimed a dividends-paid credit for this $55,000 distribution (R. 197–199), and the Commissioner sought no review of the Tax Court's ruling in petitioner's favor (R. 258).

Since its incorporation, the petitioner's income has been derived from its leasehold. From 1924 to 1933, McCrory Stores Corporation was the sole tenant of the leasehold. Since 1933 that company has occupied only a portion of the premises, and the remainder has been sublet by the petitioner (since July 1, 1935 (R. 39)) to Robin Redbreast Hosiery Company, Inc., at a rental of a certain percentage of the latter's gross sales, which required the monthly submission of statements by the tenant to the petitioner. The last mentioned lease is for a period ending June 30, 1945. In the tax year, 1936, the petitioner, under an arrangement effective September 1, 1936, employed a bank in Cleveland as its agent in the collection of rentals and for the payment of the ground rent and taxes due from it. Any balance of income re-

maining was to be distributed by the agent on the petitioner's written instructions. (R. 189–190.)

During the period July 1, 1935, to June 30, 1936,[2] considerable time and effort were required on the part of the petitioner in securing the settlement with the McCrory Stores Corporation of the petitioner's claim against it in bankruptcy. The petitioner's board of directors held three special meetings between July 1, 1935, and June 30, 1936. These were the only formal directors' meetings that were held. No formal meeting of the stockholders was held during that period. The Robin Redbreast Hosiery Company, Inc., covenanted in its lease to keep and maintain the premises demised to it, including plumbing and electrical fixtures, elevators, etc., in good condition and repair. The petitioner covenanted to make all necessary repairs to the roof and sidewalk adjoining the premises. McCrory Stores Corporation covenanted in its lease to keep the interior of the premises demised to it in good repair, including the store fronts, show windows, and entrance way; and the petitioner covenanted to keep the exterior of the premises, including the sidewalk, in good repair, and to carry insurance against fire and lightning. Similar covenants covering repairs were contained in the earlier

[2] This is the period with which Secs. 105 and 106 (a) of the Revenue Act of 1935, as amended, are concerned (*supra*, pp. 2–3).

lease to McCrory Stores Corporation. (R. 190–191.)

The Commissioner included the $35,000 above mentioned in the petitioner's gross income for the tax year 1936 as prepaid rental (R. 24, 25), and, as a result of this and other adjustments, determined deficiencies in income and excess profits taxes of $17,014.24 (R. 27) and $7,310.72 (R. 26), respectively.

The Tax Court found and held that the $35,000 was paid to the petitioner as rent (R. 195–198). The Tax Court also rejected the petitioner's contention that it was not doing business from July 1, 1935, to June 30, 1936, and held that it was therefore not to be relieved from the excess profits tax it had paid in accordance with the return it had filed (R. 199–200). However, in view of other adjustments made by it, the Tax Court redetermined the deficiencies in the petitioner's income and excess profits taxes for the periods involved to be $8,230.33 and $5,939.95, respectively (R. 201).

The circuit court of appeals affirmed the decision of the Tax Court (R. 255).

ARGUMENT

1. The question as to the taxability of the $35,000 which the petitioner received from its lessee, the McCrory Stores Corporation, at the time of the execution of the new sublease of the premises for the period from June 1, 1936, to

December 31, 1955, depends for its solution upon the peculiar facts in the case, particularly on the terms of the lease itself. The court below so viewed the problem (R. 260); for, as it stated, the sum was to be repaid, in whole or in part, under circumstances which might never occur and of a kind so limited as to be an insufficient basis for requiring that sum to be categorized as primarily not intended as rent (R. 261). It correctly held that the lease here supports the Tax Court's decision (R. 261). Cf. *Brown* v. *Helvering,* 291 U. S. 193, 199.

The decision of the court below is not, as the petitioner asserts (Pet. 13–14; Br. 18–19), in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Clinton Hotel Realty Corp.* v. *Commissioner,* 128 F. 2d 968. As the court below pointed out (R. 261), in so far as any expressions in the *Clinton Realty* case appear to be inconsistent with its decision in the instant case, such expressions "were qualified by a subsequent case in the same Circuit, *Astor Holding Co.* v. *Commissioner,* 135 F. (2d) 47 (C. C. A. 5) where the Court decided against the taxpayer on facts very similar to those of the instant case."[3] The decision of the Circuit Court of

[3] That the facts in the *Astor Holding Company* case are substantially similar to those of the case at bar is disclosed by the memorandum opinion of the Board of Tax Appeals of July 30, 1942 (1942 P–H B. T. A. Memorandum Decisions, par. 42,435), where the applicable provisions of the lease there in question are set out in full.

Appeals for the Fifth Circuit in the *Astor* case, which approved the inclusion of the amount there involved in the lessor's gross income, is in complete accord with the decision of the court below in the case at bar. In its opinion in the *Astor* case, the circuit court of appeals differentiated that case from the *Clinton Realty* case, where the amount paid was held not to be includible in the lessor's gross income. In so doing, the court pointed out that the amount paid in the *Clinton Realty* case was actually only a deposit or security for rent, because it was always referred to as "security" or "deposit" and because the lessor was required to account to the lessee for the principal thereof and the interest thereon. There were no such requirements in the lease involved in the *Astor* case, nor are there such requirements involved in the lease in the case at bar.

Warren Service Corp. v. *Commissioner,* 110 F. 2d 723 (C. C. A. 2d), which the petitioner inferentially asserts is also in conflict with the decision of the court below (Pet. 13), is a decision of that court and was said by it to be substantially different from the instant case (R. 261). The distinction is apparent, since in the *Warren Service Corporation* case the lessor was required to hold the $125,000 which the lessee had there paid it upon the execution of the lease in 1926 and to repay it to the lessee in full in 1941, unless it had in the meantime been appropriated by the

lessor to make good a default by the lessee. In other words, the amount was paid to the lessor only as a deposit to guarantee the performance of the lease by the lessee. The real question in that case was whether and how much income there was in 1933 when the lease and the obligation to repay the $125,000 was cancelled.

The decision of the Circuit Court of Appeals for the Ninth Circuit in the case of *Commissioner* v. *Lyon,* 97 F. 2d 70, also referred to by taxpayer (Pet. 14), is in accord with the decision of the court below in the instant case, for in the *Lyon* case the court held that a sum of money paid under the terms of a lease upon execution thereof, entirely without restriction concerning its disposition, was taxable in the year of its receipt.

2. Nor is there any basis for the petitioner's assertion (Pet. 14) that the determination of the court below on the "doing business" question is "in conflict with the weight of authority and applicable decisions of this Court", the decisions referred to being listed on pages 26–27 of its brief supporting its petition.

Both the Tax Court (R. 199–200) and the court below (R. 261) correctly held that the petitioner was doing business in the taxable year. The Tax Court found the facts in some detail (R. 189–191), and, in its opinion, stated that the petitioner "was organized to acquire a long-term leasehold and to make profit from subleasing the premises" (R.

199). It concluded, therefore (R. 200), that the petitioner's activities during the tax year brought it well within the rule as to what constitutes doing business laid down by this Court in *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, and *Magruder* v. *Washington, B. & A. Realty Corp.*, 316 U. S. 69, and distinguished *McCoach* v. *Minehill Railway Co.*, 228 U. S. 295, upon which the petitioner relies, on the ground that the taxpayer there had, for all practical purposes, discontinued its business.

CONCLUSION

We believe the questions here presented are not of sufficient general importance to warrant review of the decision of the court below with respect thereto; and, since there is no conflict upon either question, and the decision below is correct, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1944.

U. S. GOVERNMENT PRINTING OFFICE: 1944

FILED
SEP 29 1944
CHARLES ELMORE CROPLEY
CLERK

IN THE

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REPLY BRIEF FOR THE PETITIONER

ELLIOT A. DAITZ,
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Law Brief Press—NYC

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

1. The case of *Brown* v. *Helvering*, 291 U. S. 193, 199, cited in the respondent's brief at page 9, is one in which the taxpayer had an *absolute* right to earnings as distinguished from the security in the instant case, in which the petitioner had no absolute right. There was no question that the premuim in the *Brown* case became the absolute property of the taxpayer when received, and consequently, the commissions were income at that time. In the instant case, The Hirsch Improvement Company's right to the $35,000.00 security fund was contingent upon its eventual application as rent, but it did not receive the fund as rent or *earnings*.

The distinction between the *Astor Holding Co.* case, 135 F (2d) 47 (C. C. A., 5) (cited at p. 9 of the respt's br.), and the instant case has been set forth in the petitioner's brief (p. 19).

The advance rental in the instant case was the $25,000.00 which the petitioner has conceded as taxable income in year 1936. A clear distinction is indicated between the said $25,000.00 and the $35,000.00 fund in question. The latter, by the terms of the lease, was described as *security* (R. 146), and was so received by the petitioner.

2. In the light of this Court's decision in *United States* v. *Emery, Bird, Thayer Realty Company,* 237 U. S. 28, the cases cited at page 12 of the respondent's brief are not applicable to the facts in the instant case on the "doing business" question.

In *Edwards* v. *Chile Copper Co.,* 270 U. S. 452 (respt's br., p. 12), the taxpayer was furnishing funds to the Exploration Company, from time to time to assist said company in its work. The taxpayer was actively seeking new profit.

In *Magruder* v. *Washington, B. & A. Realty Corp.,* 316 U. S. 69 (respt's br., p. 12), the taxpayer was selling property and engaging in other activities, and in the language of this Court, "did not fall into that state of quietude, covered by the specific language of Article 43 (b) (2), [pet's br., p. 5], in which it was merely owning and holding specific property and distributing the resulting proceeds."

In the instant case the petitioner's organization and activities specifically fall within the provisions of the Commissioner's regulations,—Article 43 (b) (2) *supra.* (See also, *Harrisburg Hotel Company* v. *U. S.,* C. C. A., 3, No. 8557, August 28, 1944, reported in Prentice Hall 1944 Federal Tax Service, Paragraph 62,708.)

CONCLUSION.

The petitioner respectfully urges that the questions here presented are of material importance and warrant review of the decision of the Court below, particularly in view of the conflict and the unsettled state of the decisions on both issues. The petition for a writ of certiorari should be granted.

Respectfully submitted,

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September, 1944.